



Appeal of Y. W. and Lois M. Glazebrook,

Until its dissolution in March 1978, Y. W. and Lois M. Glazebrook (hereinafter referred to as "appellant-husband" and "appellant-wife," respectively, and collectively referred to as "appellants") were the sole shareholders and officers of Arrow Hardwood Floor Company (hereinafter referred to as "Arrow"). On October 30, 1976, Arrow terminated its qualified retirement plan and directed that the funds in that plan be distributed to appellants, the plan's sole beneficiaries, in such a manner that those funds would "roll over" into Individual Retirement Arrangements ("IRAs"), thereby avoiding immediate taxation.

On December 28, 1976, appellants received a combined distribution of \$38,280.88; \$31,276.60 allocable to appellant-husband and \$7,004.28 allocable to appellant-wife. The plan's administrator, Affiliated Plans Administrators, Inc., claims that this first distribution was not represented to appellants as constituting the balance of their credit in the plan at the time of its termination. This initial distribution, which represented the investment portion of Arrow's retirement plan, was "rolled over" in IRAs. On January 17, 1977, appellants received, from the annuity portion of the plan, the combined amount of \$13,260.94. One week later, they received another \$168.74 representing additional interest earned in 1976. On January 27, 1977, appellants deposited the amounts received in that month in the IRAs established the previous year.

Later in 1977, appellants withdrew the aforementioned distributions from their IRAs and attempted to redeposit the funds with the previously terminated retirement plan. Arrow then adopted a new resolution reaffirming the plan's termination, and the funds were subsequently redistributed to appellants, who immediately deposited those amounts into IRAs.

Upon examination of their joint California personal income tax returns for the years in issue, respondent discovered that appellants had not included the retirement plan distributions in their gross income for 1976 and 1977. The subject notices of proposed assessment were subsequently issued reflecting respondent's determination that those distributions constituted gross income to appellants for the years in which they had originally been paid. Upon consideration of appellants' protest of its action, respondent affirmed its determination, thereby resulting in this appeal.

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The sole issue presented by this appeal is whether respondent properly determined that the aforementioned distributions constituted gross income to appellants for the years in which they were originally paid.

For the years in issue, former subdivision (e) ^{1/} of section 17503 ²¹ of the Revenue and Taxation Code provided that distributions of the type in issue here would not be includible in gross income for the year in which paid if, among other requirements, they were paid as follows:

(A) Within one taxable year of the employee on account of a termination of the plan of which the trust is a part or a complete discontinuance of contributions under such plan, or

(B) In one or more distributions which constitute a lump-sum distribution within the meaning of Section 402(e)(4)(A) of the Internal Revenue Code of 1954 as amended by the Employee Retirement Income Security Act of 1974 [ERISA] (P.L. 93-406) (determined without reference to subsection (e)(4)(B)). (Emphasis added.)

Section 402(e)(4)(A) of the Internal Revenue Code of 1954, as amended by ERISA, provides, in pertinent part, as follows:

^{1/} AB 302 (Stats; 1977, Ch. 1079), operative for taxable years beginning in 1977, renumbered subdivision (e) to (d). Hereinafter, all references to former Revenue and Taxation Code section 17053, subdivision (e), incorporate by reference former subdivision (d) of that section as operative for taxable year 1977.

^{2/} AB 93 (Stats. 1979, Ch. 1168), operative for taxable years beginning on or after January 1, 1979, repealed former subdivision (d) of section 17503 and added new subdivisions (d), (e), (f), and (g) concerning rules for treatment of lump sum distributions.

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(A) Lump-sum distribution.--For purposes of this section and section 403, the term "lump-sum distribution" means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee ...

* * *

from a trust which forms a part of a plan described in section 401(a) and which is exempt under section 501 or from a plan described in section 403(a)
(Emphasis added.)

As previously indicated, the record of this appeal reveals that appellants were paid portions of the balances of their accounts in the retirement plan in two taxable years: 1976 and 1977. Such a distribution did not constitute a "lump-sum distribution" as that term is defined in section 402(e)(4)(A) of the Internal Revenue Code of 1954. Accordingly, we must conclude that appellants' "rollover" into IRAs of the distributions paid to them did not qualify for tax-free treatment under former section 17503, subdivision (e). (See Lee L. Blyler, 67 T.C. 878 (1977).)

Appellants' apparent attempt to receive a qualifying "lump-sum distribution" by transferring the funds already deposited into IRAs back to the previously terminated retirement plan and subsequently redepositing the funds redistributed to them into IRAs was ineffective for at least the following two reasons: (i) the plan had already been terminated; and (ii) appellants had previously received, and exercised control over, the distributed amounts.

'Appellants have argued that "[s]ince the Internal Revenue Service has accepted our rollover as a legal IRA, we feel the State of California should do the same." While we can appreciate the confusion resulting from the conflicting treatment of their "rollover" by federal and state taxing authorities, we must nevertheless reject appellants' reasoning. A review of the statutory history of the relevant federal and California provisions reveals that the former, section 402(a).(5) of the Internal Revenue Code of 1954, was amended in 1978 to permit "partial" rollovers; that amendment was made retroactive to taxable years beginning on or after December 31, 1974. (Pub. L. No. 95-458, 26 U.S.C. § 402

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(1978).) The California counterpart to the federal provision, former subdivision (e) of section 17503, was also amended to allow such "partial" rollovers: that amendment, however, was made operative only for taxable years beginning on or after January 1, 1979. (AB 93 (Stats. 1979, Ch. 1168.)) That diversity in the pertinent federal and California provisions explains why appellants' "partial" rollover was accepted by the Internal Revenue Service and why it was rejected by respondent.

Appellants allege that they have "documented proof" indicating that the administrator of Arrow's retirement plan represented that it paid them a qualifying "lump-sum distribution" in 1976. Whatever may have been the nature of the administrators' representations to appellants, the record of this appeal clearly reveals that it made the aforementioned distributions to appellants over two taxable years; such a distribution, as set forth above, did not constitute a "lump-sum distribution" under former section 17503, subdivision (e).

For the reasons set forth above, respondent's action in this matter will be sustained.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Y. W. and Lois M. Glazebrook for refund of personal income tax in the amounts of \$4,188.02 and \$1,477.40 for the years 1976 and 1977, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of December , 1981, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Reilly, Mr. Bennett, Mr. Nevins and Mr. Cory present.

Ernest J. Dronenburg, Jr. , Chairman

George R. Reilly , Member

William M. Bennett , Member

Richard Nevins , Member

Kenneth Cory , Member .